

THIRD QUARTER FINANCIAL MARKET COMMENTARY  
“NINETY DAYS IN NINETY SECONDS”  
SEPTEMBER 30, 2020

THE KNOWABLES AND PREDICTABLES ABOUT THE FUTURE

- ♦ Uncertainty is rampant and political, economic, social and environmental issues are hotly debated. This has led to contrasting views among investors that either the economy is getting better based upon incremental positives or the world is still challenged as a result of the absolute level of negative data.
- ♦ Even amid this uncertainty, there are a number of constants. The Fed's zero interest rate policy is likely to remain in place through 2023. Likewise, the global economy has rebounded from the pandemic faster than expected. Corporate revenues and profits have been much more resilient than feared and stocks have responded positively to those fundamental factors.
- ♦ Congress is expected to pass another stimulus bill reasonably soon, assuming political disagreements can be overcome. A sizable stimulus package would set GDP growth on a path to pre-Covid levels several quarters earlier than most economists are currently forecasting. In a best case scenario, this stimulus package would provide economic support that would overlap with a multi-pronged medical resolution to the spread of Covid cases.

THE UNFORECASTABLES

- ♦ It has been surprising that the presidential campaign has not had much impact on the financial markets. Largely based upon his tax proposals, a Biden presidency is typically viewed as less investor-friendly than a Republican administration. Yet there has been virtually no attribution of market volatility to Biden's consistent lead in the polls.
- ♦ Since presidential elections are only held every four years, there is not enough historical data to produce statistically significant forecasts. The limited historical data would imply higher volatility in the six weeks preceding the election and a post-election rally. This is somewhat logical as election uncertainty could spark a selloff, while the election results could result in a relief rally.
- ♦ A delayed or inconclusive election outcome could reverse this historical pattern. Our country's only reference point was the Bush v. Gore election in 2000. In that case the election wasn't decided for five weeks and stocks fell 4% from election day until the Supreme Court ruling on December 12th. The deepest decline during this period of uncertainty was about 8%, which is well within the range of normal market volatility.
- ♦ Further increasing political uncertainty is the battle for control of the Senate. A non-consensus view is that a Democratic sweep yields more fiscal stimulus, more infrastructure spending, and more state/local aid. This combination arguably results in a much stronger cyclical recovery.

### THE THIRD QUARTER

- ♦ The Federal Reserve has continued to provide liquidity to the credit markets and pledged to hold short term interest rates near zero for the next three years. This accommodative stance has had positive repercussions across the capital markets. High yield bond issuance was higher in nine months than the full year record in 2012. In the equity markets, year-to-date initial public offerings have raised more capital than any calendar year since 2014. Dividends and stock buybacks are beginning to be resumed by companies across a broad spectrum of industries.
- ♦ Economic data reflects a broad post-lock down recovery on Main Street, as well as Wall Street. Retail sales are above pre-Covid peaks, while consumer confidence has also rebounded sharply. Home sales, building permits and housing starts are all reflective of low interest rates and strong demand for housing.
- ♦ Inflation presents an interesting set of data. The so-called core CPI jumped 0.6% in July and 0.4% in August. The July price surge was the biggest single month increase since 1991. An interesting observation by a Wall Street Journal columnist is that the reported inflation rate understates actual consumer experiences. His logic is that the subset of items being purchased during the Covid environment are experiencing rapidly rising prices, while items that are still part of the CPI, but are not being consumed, i.e., airfares and hotel rooms, are falling.

### COVID-19

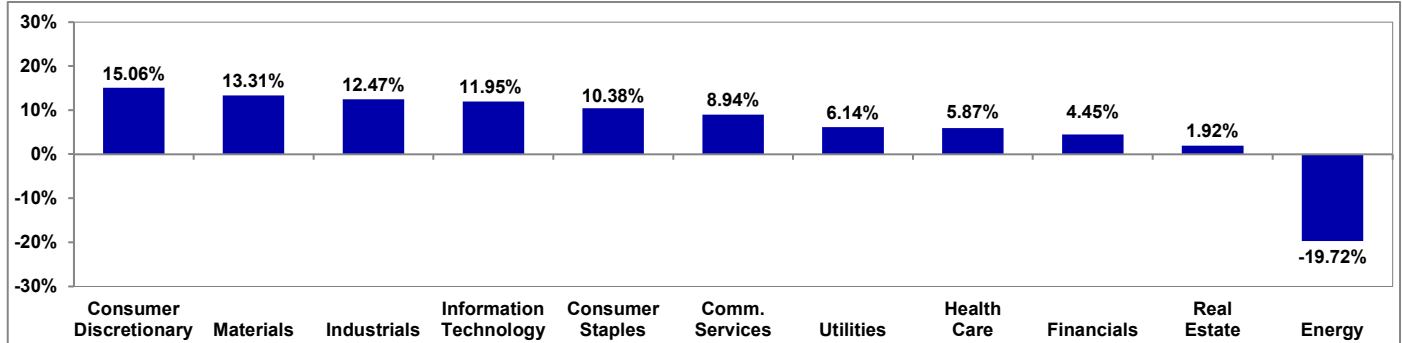
- ♦ Vaccines, test kits, and therapeutic treatments are rapidly moving from the lab to the consumer. The Milken Institute has validated 316 treatments that are in various stages of development and 213 vaccine candidates. Treatments will help existing patients while the vaccines will hopefully protect the population from Covid-19 or other coronaviruses. These are key medical advancements that are needed to fully reopen the economy.
- ♦ As the calendar moves towards cooler temperatures, there is a risk of a fall surge in new cases. Unfortunately, social distancing will likely be a term that remains in our vocabulary for at least the intermediate future.

### CONCLUSION

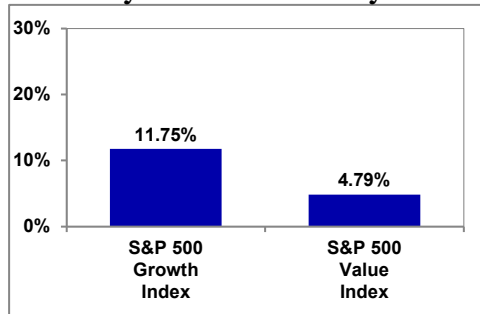
- ♦ TINA is an acronym that surfaced a few years ago and means "there is no alternative" to owning stocks. The Fed's policy stance of holding short term interest rates near zero is likely to drive assets out of money market funds and into stocks as investors search for alternative sources of income. Given that investors have parked a near record \$4.4 trillion in cash accounts with virtually no income, the reinvestment of those dollars into stocks could be a major catalyst for higher stock prices.
- ♦ The election in November will grab the headlines, but the market always returns to earnings and interest rates as the key determinants of long term value. Reasons to be cautious largely revolve around politics, tax policy, Covid, and disruptions to consumer-facing businesses. On the positive side are zero interest rates, revenue/earnings growth across multiple sectors, Covid treatments/vaccines, and reopening trends/pent-up demand. Lastly, there are a large number of stocks beyond the mega-cap growth names that continue to trade at reasonable valuations.

### Third Quarter Investment Performance (including income)

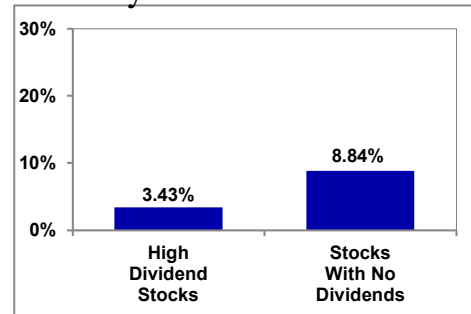
#### By Economic Sector



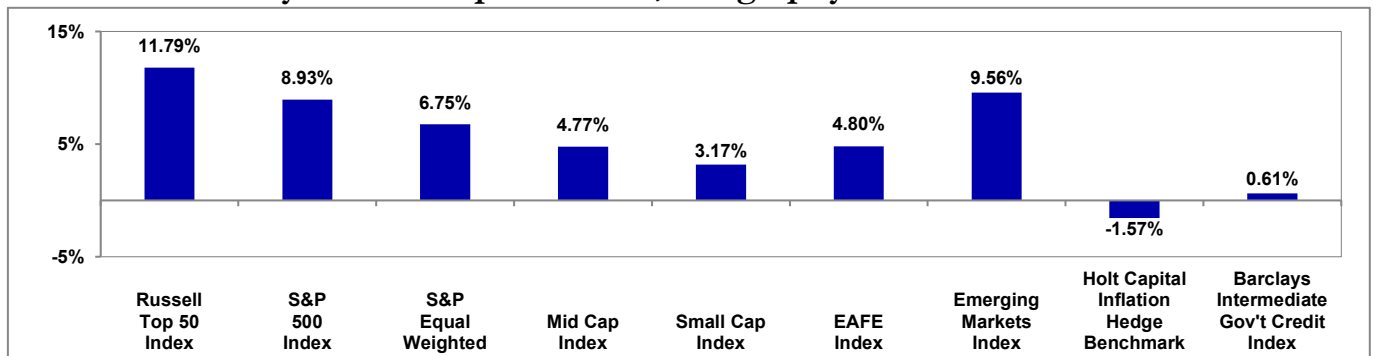
#### By Investment Style



#### By Dividend Yield



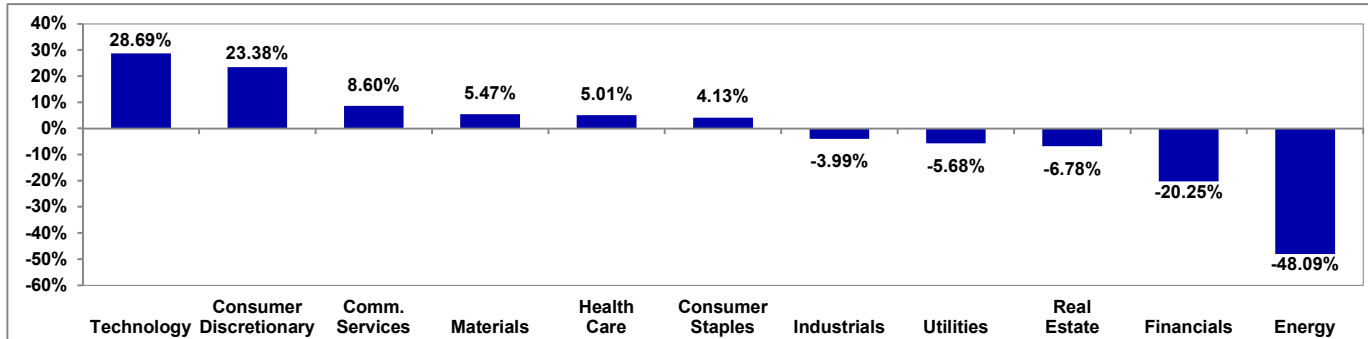
#### By Market Capitalization, Geography and Asset Class



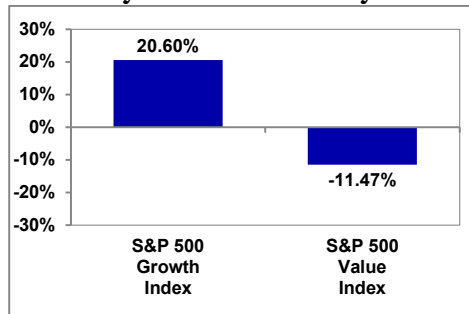
- ♦ Although it is not universally reflected in the data, market leadership began to broaden in September when value indexes outperformed growth indexes for the first time in twelve months.
- ♦ Sector returns also reflect a more broad-based rally in the third quarter. Six sectors outperformed the S&P 500 Index, which compares to only three sectors during the more narrow year-to-date period.
- ♦ Company size continues to benefit the mega-cap stocks, while all other market capitalizations lag. This is largely a manifestation of the so-called "winner take all" economy.

**Year-to-Date Investment Performance (including income)**

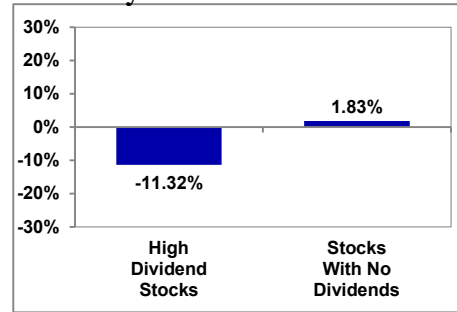
**By Economic Sector**



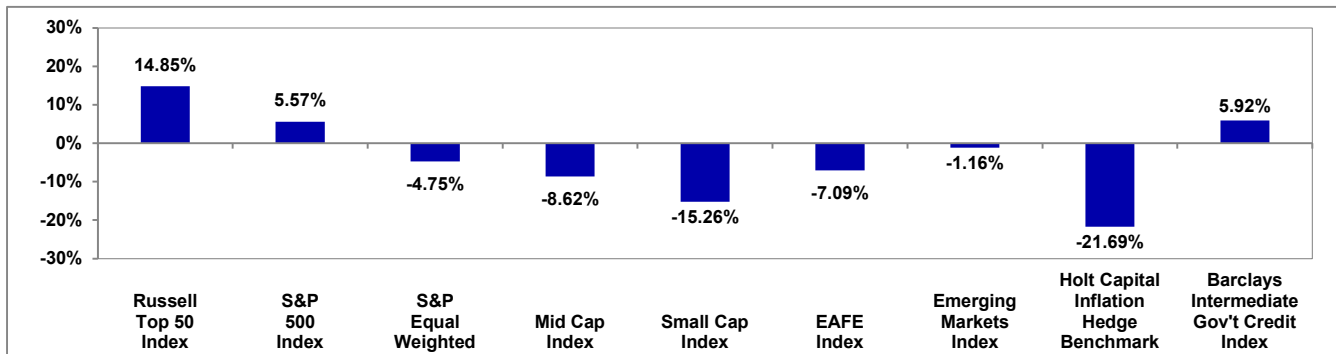
**By Investment Style**



**By Dividend Yield**



**By Market Capitalization, Geography and Asset Class**



- ♦ The average large cap stock, as measured by the S&P 500 Equal Weighted Index, generated a year-to-date total return of -4.75%. A further reflection of the market's narrow leadership is the fact that over 56% of the index's constituents have generated negative returns.
- ♦ The performance gap between underperforming value indexes and trendy growth stocks during this market cycle is wider than at any time in the 84 year history of the data. While value is analytically interesting, predicting the catalyst that will cause this trend to experience mean reversion is likely an exercise in uncertainty.
- ♦ The three economic sectors that have outperformed the S&P 500 were each dominated by one or two stocks. Technology returns were dominated by Apple and Microsoft, discretionary sector returns were propelled by Amazon, and communications received an outsized benefit from Facebook.